Wall Street targets drop as reality sinks in

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By Ellis Mnyandu

NEW YORK (Reuters) - The realization that the U.S. economy faces serious headwinds is wearing Wall Street down and strategists are finally being swayed to trim their end-2008 targets for benchmark indexes.

Wednesday's market rally notwithstanding, Wall Street's forecasters are taking a cautious stance given that it's only three weeks into the new year and January appears on track to being one of the worst months on record.

Citigroup was the latest to cut its year-end targets for the S&P and Dow on Wednesday, following a drop in S&P earnings estimates from Bank of America a day earlier. While Goldman's Sachs Group's widely followed Abby Joseph Cohen is sticking with her estimates, she is still expressing caution about 2008.

Citigroup cut its targets for the benchmark S&P 500 .SPX and the blue-chip Dow Jones industrial average .DJI, saying profit growth was unlikely to underpin equities in the near term as concerns mount about a recession.

"The stock market is having a difficult time digesting that we are moving into a much slower year here," said Steven Sheldon, director of SMS Capital Management in Houston, Texas. "I'm surprised it's taken this long to see targets lowered."

At Wednesday's close, the S&P 500 was down 8.8 percent year-to-date, while the Dow was off more than 7 percent as recession fears diminish investors' appetite for riskier assets.

The Nasdaq .IXIC, on the other hand, is down more than 12 percent since the start of 2008, a slide that has seen it dip and then recover from a level that typically marks the onset of a bear market.

Even so, the pace at which Wall Street's expectations for where indexes might end 2008 has lagged the market's tumble, leading some analysts to worry that before too long, a dose of reality might worsen the market's slide.

U.S. stocks would appear to be at their cheapest in 13 years, with a multiple of less than 13 times, after the worst start to a year on record.

But while the broader market is 16 percent off its October high, aggregated S&P 500 earnings expectations for 2008 have come down only 5.4 percent and rolling 12-month expectations have contracted only 2.4 percent over the same time.

Tobias Levkovich, chief U.S. equity strategist at Citigroup, cut his S&P 500 target to 1,550 from 1,675. He reduced his Dow target to 13,950 from 15,100.

"Given an awful beginning for stock prices and the unlikely proposition for earnings to provide much relief near term," he said in a note to clients, "we no longer believe that the first-half 2008 equity market strength will be achieved.

"Keep in mind that a 15 percent drop in stock prices may have clipped more than $2.5 trillion from U.S. household net worth in the past three months."

Should the U.S. Federal Reserve continue to cut interest rates, maybe more pre-emptively, the equity market could stabilize and rebound, Levkovich added.

The Fed cut its overnight benchmark interest rate by 75 basis points in an emergency move on Tuesday, bringing the federal funds rate down to 3.5 percent.

Levkovich's reduced views came a day after Thomas McManus, chief investment strategist at Bank of America Securities, a unit of Bank of America Corp(BAC.N: Quote, Profile, Research) , reduced his S&P 500 earnings estimate to $95 from $98 for 2008, and to $105 from $108 for 2009.

He said 1,550 was now a reasonable year-end target compared with a prior projection of 1,625.

Cohen, the chief investment strategist at Goldman Sachs, has not changed her 2008 estimates, but said in a CNBC television interview on Tuesday that "now is the time still to be somewhat cautious." Her targets call for the Dow to end the year at 14,750 and the S&P 500 to finish at 1,675.

Two weeks ago, Goldman Sachs forecast a U.S. recession for 2008, saying U.S. real gross domestic product would contract by 1 percent on an annualized basis in the second and third quarters.

(Reporting by Ellis Mnyandu; Editing by Dan Grebler)

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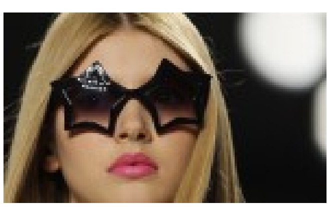

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